

FAIR POLITICAL PRACTICES COMMISSION
Memorandum

To: Chairman Randolph, Commissioners Blair, Downey, Huguenin, and Remy

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Subject: Prenotice Discussion of Proposed Amendments to Regulation 18438.5

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I. EXECUTIVE SUMMARY

This project examines potential issues relating to contributions received from individuals or entities with an ownership interest in a person who is a party to a proceeding before an agency under section 84308 of the Political Reform Act (the “Act”)¹.

According to section 84308, an officer of a public agency is disqualified from participating in certain decisions affecting a party from whom the official has received campaign contributions of more than \$250 within the 12 months preceding the decision. (Section 84308(c); regulations 18438.1 - 18438.8.) This project explores the possibility of adding a new regulation further defining “parties to a proceeding” under section 84308, and thereby extending the campaign contribution limitation and disclosure provisions provided therein to, parents, subsidiaries and “otherwise related business entities” as that term is defined in the Act’s conflict-of-interest provisions, to other business entities who have a financial interest in an entity involved in the proceeding. If this regulation is not adopted, the campaign contribution standard of “direction and control,” which is also being considered by the Commission concurrent with this project, will be the standard for determining aggregation of contribution under section 84308.

II. BACKGROUND

One of the stated purposes of the Political Reform Act, as set forth in section 81001, subdivision (b), is to assure that “[p]ublic officials, whether elected or appointed, should perform their duties in an impartial manner, free from bias caused by their own

¹ The Political Reform Act is contained in sections 81000 through 91014 of the Government Code. All statutory references are to the Government Code unless otherwise indicated. The regulations of the Fair Political Practices Commission, enacted pursuant to the provisions of the Act, are contained in sections 18109, et seq., of title 2 of the California Code of Regulations. All regulatory references are to title 2, division 6 of the California Code of Regulations, unless otherwise indicated.

financial interests or the financial interests of persons who have supported them.” In furtherance of that mandate, the Act, from its inception in 1974, included detailed conflict-of-interest provisions that were designed to prohibit any public official from making, participating in making, or otherwise using his or her official position to influence a governmental decision in which the official has a financial interest. As originally enacted, the Act contained no provision that would make the receipt of campaign contributions a basis for a public official’s disqualification from making a governmental decision.

Although the basic conflict-of-interest rule stated in section 87100 provides that no public official shall make, participate in, or use his official position to influence a governmental decision in which he or she has a financial interest, campaign contributions are not considered a financial interest under the Act. Although section 87103, subdivision (c) provides that a financial interest includes sources of income and subdivision (e) includes sources of gifts, section 82030, defining income, provides that income does not include campaign contributions and section 82028, defining gifts, also provides that campaign contributions are not included within the definition of the term gift.

This changed, however, in 1982. In that year, section 84308 was added to the Act by the Legislature to make the receipt of campaign contributions, in certain situations, the basis for a public official’s disqualification from making a governmental decision. The statute was enacted in specific response to reports in the *Los Angeles Times* that several coastal commissioners had solicited and received large campaign contributions from persons who had applications pending before them. The purpose of the statute was to assure that appointed members of boards or commissions are not influenced by the receipt of, or the prospect of receiving, campaign contributions from the persons appearing before them, or are able to use their position of authority to unduly influence applicants to make contributions to their campaigns.

Section 84308 applies to all appointed officers of any state agency or local government agency, with the exception of the courts or any agency in the judicial branch of government, the Legislature, the Board of Equalization, constitutional officers, and any local governmental agencies whose members are directly elected by the voters. (Section 84308(a)(3).)

Section 84308 imposes two requirements on officers subject to the section. First, “[n]o officer of an agency shall accept, solicit, or direct a contribution of more than two hundred fifty dollars (\$250) from any party, or his or her agent, or from any participant, or his or her agent, while a proceeding involving a license, permit, or other entitlement for use is pending before the agency and for three months following the date a final decision is rendered in the proceeding.” (Section 84308(b).)

Secondly, if an officer has in fact accepted a contribution of more than \$250 during the last 12 months from a party or participant in a proceeding involving a license, permit, or other entitlement for use pending before an agency, the officer must disclose

that fact on the record of the proceeding and must disqualify himself or herself from participating. (Section 84308(c).)

Additionally, section 84308 imposes separate requirements on parties² to a proceeding, stating that any party to a proceeding must disclose on the record of the proceeding any contribution of more than \$250 made within the preceding 12 months by the party or the party's agent to any officer of the agency and prohibits the party, or his or her agent, from making any contribution of more than \$250 to any officer of that agency during the proceeding and for three months following the date a final decision is rendered by the agency in the proceeding. (Section 84308(d).)

Finally, section 84308 provides that when a closed corporation is a party to, or a participant³ in, a proceeding the majority shareholder is subject to the disclosure and prohibition requirements of the section. (Section 84308(d).)

III. ISSUE

With the exception of the last provision of the statute, which states that majority shareholders of closed corporations are subject to the disclosure and prohibition requirements provided therein, in effect requiring that these contributions be considered to have been received from the party, the statute makes no mention of how such contributions are to be treated if received from other individuals or entities that have a ownership link or connection with a party or participant. This project considers whether regulatory clarification is necessary under this section, and if the rule should be based solely on the "direct and control" standard used for aggregation of campaign contributions or the stricter "otherwise related business entity" test used as the standard for conflict-of-interest cases.

The issue has been previously explored as a regulatory project in 2000. However, the regulation project did not proceed beyond prenotice discussion.

The Enforcement Division proposed consideration of this issue as part of the regulatory calendar for 2005 because of continuing potential problems in the enforcement of section 84308 when contributions are received from a person who has an ownership interest in a party to a proceeding, but is not technically a party under the current definition. While the rules applicable to aggregation of contributions would apply, those rules may not be broad enough to effectively prevent the types of contributions the statute was designed to prevent.

² "'Party' means any person who files an application for, or is the subject of, a proceeding involving a license, permit, or other entitlement for use." (section 84308(a)(1))

³ "'Participant' means any person who is not a party but who actively supports or opposes a particular decision in a proceeding involving a license, permit, or other entitlement for use and who has a financial interest in the decision, as described in Article 1 (commencing with Section 87100) of Chapter 7. A person actively supports or opposes a particular decision in a proceeding if he or she lobbies in person the officers or employees of the agency, testifies in person before the agency, or otherwise acts to influence officers of the agency."

IV. OPINIONS AND ADVICE LETTERS

Long standing Commission advice with respect to aggregation of contributions has followed the “direction and control” standard first enumerated by the Commission in the *Lumsdon* and *Kahn, supra* opinions. (*In re Lumsdon* (1976) 2 FPPC Ops. 140 and *In re Kahn* (1976) 2 FPPC Ops. 151.)⁴ This standard was later codified in regulatory form, setting forth the rule for “aggregation by affiliated entities.” The regulation was later enacted in statutory form as is now contained in section 85311 and applies only “for purposes of” the campaign contribution limits portion of the Act.

Absent a separate standard for the purposes of the limits and conflicts-of-interests reporting obligations set forth in section 84308, Commission advice in addressing aggregation issues under this section have borrowed from and applied the standard first enunciated in *Lumsdon* and *Kahn*. (*Stergakos* Advice Letter, No. I-04-149.)

Language taken from a recent letter, *Stergakos, supra*, is instructive as to the general guidance provided with respect to aggregation issues under section 84308:

“We have long advised that if one person ‘directs and controls’ the contributions of two or more persons, the contributions of all will be aggregated to determine whether the recipient candidate is disqualified from taking any part in a proceeding governed by section 84308. (citations omitted.) This rule is an interpretation of the statutory reference to ‘agents,’ designed to inhibit circumvention of the law through the use of intermediaries.

“The term ‘directs and controls’ is used to explain similar aggregation rules elsewhere in the Act, most notably in section 85311, to deter circumvention of contribution limits. This provision was originally drafted in 1995 by Commission staff as regulation 18225.4, outlining the circumstances under which independent expenditures would be aggregated. It was accompanied by a parallel regulation, repealed in the aftermath of Proposition 208, which governed the aggregation of contributions. Regulation 18225.4 was then codified by Proposition 34 as section 85311, to safeguard the contribution limits introduced by that measure.

“These two regulations and the new statute were designed to ‘codify’ two 1976 Commission Opinions, *In re Lumsdon* 2 FPPC Ops. 140, and *In re Kahn* 2 FPPC Ops. 151 ... which generally set out the Commission’s views on the aggregation of contributions. These opinions also inform our longstanding advice

⁴ These opinions involve aggregation of contribution for purposes of determining the reporting obligations of “major donor” committees.

on the aggregation of contributions under section 84308. Thus even though section 85311 and regulation 18225.4 do not formally govern the interpretation of section 84308, the Commission's rules on aggregation are consistent throughout the Act, and you may consult these provisions, along with the opinions mentioned above, for guidance on the aggregation of contributions under section 84308."

V. DISCUSSION

This project seeks to examine whether or not "consistency throughout the Act" should be the determining factor in applying the "direction and control" aggregation rules to contributions under section 84308 or, in the alternative, if it would be more consistent, or more appropriate, to treat contributions for purposes of section 84308 more along the lines established under the current conflicts-of-interest standard, which, for example, combines parent and subsidiary business entities in considering an economic interest. A strong argument can be made that, given the background and intent of the statute, the conflicts standard of otherwise related business entities would be more appropriate. While section 84308 does impose contributions limits, these limits are imposed in an attempt to reduce influence on certain officials who make decisions affecting the contributors, making section 84308, essentially, more in the nature of a conflicts-of-interest provision than a contribution limit provision.

Regulation 18703.1, subdivision (d) describes the circumstances under which one business entity will be considered a parent or subsidiary of, or otherwise related to, another business entity. It provides:

"d) Parent, Subsidiary, Otherwise Related Business Entity, defined.

(1) Parent-subsidiary. A parent-subsidiary relationship exists when one corporation directly or indirectly owns shares possessing more than 50 percent of the voting power of another corporation.

(2) Otherwise related business entity. Business entities, including corporations, partnerships, joint ventures and any other organizations and enterprises operated for profit, which do not have a parent-subsidiary relationship are otherwise related if any one of the following three tests is met:

(A) One business entity has a controlling ownership interest in the other business entity.

(B) There is shared management and control between the entities. In determining whether there is shared management and control, consideration should be given to the following factors:

(i) The same person or substantially the same person owns and manages the two entities;

- (ii) There are common or commingled funds or assets;
- (iii) The business entities share the use of the same offices or employees, or otherwise share activities, resources or personnel on a regular basis;
- (iv) There is otherwise a regular and close working relationship between the entities; or
- (C) A controlling owner (50% or greater interest as a shareholder or as a general partner) in one entity also is a controlling owner in the other entity.”

Under the current “direction and control” campaign standard, contributions are aggregated and treated as if from the same source if received from different sources directed and controlled by the same person. This standard has been difficult to determine and apply, and the Commission is currently considering, concurrent with this project, amendments to clarify that standard.

However, even if those standards are made more explicit, there may still be situations where an entity would not come within the “direction and control” test, and be able to make contributions to an official who is considering a proceeding in which one of its related entities is a party. Furthermore, since contributions are aggregated only between two or more persons, if the named party in a proceeding subject to the provision of section 84308 does not make any contribution, normally, there would be nothing to aggregate. Although some advice letters have suggested that the direction and control test could be used to determine that another business entity can be identified as the same party as a related business entity for purposes of section 84308, there is no clear authority for this, regulatory or otherwise. (See *Pellman* Advice Letter, No. A-85-094; *Sutton* Advice Letter, No. A-95-156.)

Therefore, staff recommends that the Commission consider applying a conflict-of-interest standard in determining when related business entities will be treated as the same entity, or party to a proceeding, with respect to the provisions of section 84308, rather than using the campaign standard of direction and control.

The language in proposed regulation 18438.⁵ provides this option by further ascribing certain specific meaning to the underlying definition of party contained in section 84308 as follows:

For purposes of Government Code section 84308:

“(a) A person ‘files an application for, or is the subject of, a proceeding involving a license, permit, or other entitlement for use’ if the person is a named applicant in the proceeding, is a subject of the proceeding, or is a parent or subsidiary of, or is an otherwise related business entity; or, if an individual, is a

⁵ A prior regulation using this number was repealed in 1985.

controlling owner (as those relationships are defined in title 2, California Code of Regulations, section 18703.1(d)).

Subdivision (a) thereby extends the definition of party to include any business entity that is a parent, subsidiary, or otherwise related business entity to the person that has filed an application for or is the subject of the proceeding. The language also provides that the definition of “subject” would include any person named in the proceeding, but not necessarily a named applicant or the subject of that proceeding, if the person had a financial interest in the outcome of the proceeding. This would include any person who is named as a subcontractor or named subvendor to the named applicant or subject of the proceeding.

Subdivision (b) defines financial interest in the outcome of the proceeding as used in subdivision (a), with respect to persons who are additionally named in the proceeding, to apply the reasonably foreseeable material affect standard of the Act’s conflict-of-interest provisions.

Subdivision (c) clarifies that the aggregation of contribution provisions applicable under this regulation are different from the general aggregation provisions applicable to campaign contributions.

If this regulation is not adopted, the general provisions relating to aggregation of a campaign contributions will be applicable here, and determined under the concurrent regulatory project pertaining to aggregation.

Recommendation

For the reasons stated above, staff recommends that the Commission adopt the proposed language in regulation 18438.5, applying a conflict-of-interest standard in determining a party to a proceeding under section 84308. If the Commission rejects this option, the campaign standard of “direction and control” will be applied as discussed in the concurrent regulatory project regarding aggregation of contributions. Therefore, staff requests deferral of adoption until after the Commission has considered the “direction and control” regulatory project.

Attachment

Proposed regulation 18438.5